

Service Date: February 8, 1983

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DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

IN THE MATTER of the Application of)
the City of Hamilton to Establish Rates)
and Charges for Water Service.)
_____)

DOCKET NO. 82.5.33
ORDER NO. 4910a

APPEARANCES

FOR THE APPLICANT:

Donald W. McKenna, City Attorney, City Hall, Hamilton, Montana 59840.

FOR THE INTERVENORS:

John Allen, Staff Attorney, Montana Consumer Counsel, 34 West 6th Avenue, Helena, Montana 59620.

FOR THE COMMISSION:

Robert Nelson, Staff Attorney, 1227 11th Avenue, Helena, Montana 59620.

BEFORE:

John Driscoll, Commissioner and Hearing Examiner

BACKGROUND

1. On May 14, 1982, the City of Hamilton (Applicant or City) filed an application with this Commission for authority to establish water rates and charges for its Hamilton, Montana service area. The Applicant requested that the Commission approve interim rates that would generate approximately \$190,000 in annual revenues and permanent rates that would generate annual revenues of approximately \$280,000.

2. On May 3, 1982, the City of Hamilton acquired the assets and operating responsibilities of Valley Water Company, which was the utility providing water service to consumers in the Hamilton, Montana area. With the acquisition of the Valley Water Company, it became the responsibility of the City to provide water service to consumers in the Hamilton area and necessitated the City's filing of rates with this Commission for provision of that service.

3. On June 1, 1982, the Commission, having considered the data filed with the Applicant's interim application, issued Order No. 4910 granting the City interim relief in the amount of \$190,000 annually.

4. On November 23, 1982, pursuant to Notice of Public Hearing, a hearing was held in the City Council Chambers, City Hall, Hamilton, Montana, to consider implementing the Applicant's proposed water rates. At the close of the public hearing, all parties waived their rights to a proposed order and stipulated to authorize the Commission to issue a final order in this Docket. 2-4-622, MCA.

ANALYSIS AND FINDINGS OF FACT

5. At the public hearing, the Applicant presented the testimony and exhibits of:
- Thomas P. McCarthy, Consulting Engineer
 - Dennis Muth, Consulting Engineer
 - Bud Schatz, Administrative Assistant for City
 - George Hieronymus, Asst. Water Superintendent

These witnesses testified relative to: the financial condition of the water utility, the current condition of utility plant in service, the need for proposed capital improvements, the financing of proposed capital improvements, the valuation and purchase of Valley Water Company and rate structure.

6. The Montana Consumer Counsel presented the testimony of four public witnesses, whose major concern was the large increase in rates over those previously in effect for Valley Water Company.

Purchase of Valley Water Company by the City of Hamilton

7. The Valley Water Company was a privately owned water utility serving the Hamilton, Montana area and, as such, was subject to the jurisdiction of this Commission.

Approximately two years prior to the City's acquisition of the water utility, on May 3, 1982, Valley Water Company was the subject of a formal complaint proceeding, before this Commission.

8. The complaint was filed by the City of Hamilton against the Valley Water Company (Company) and assigned Docket No. 6805. The complaint alleged that the Company was creating an emergency situation because of its reluctance to improve and replace its mains beneath Highway 93, where the highway runs through Hamilton. The Company in responding to the allegations stated that it would be glad to cooperate with the City, but lacked funds to do so.

9. Subsequent to a May 15, 1980 public hearing on this complaint, the Commission issued Order No. 4659 stating that the Commission was aware that the improvements as outlined in the City's complaint were necessary. The Commission, in the Order, also stated that it was cognizant of the fact that the Company did not have the financial ability to make the improvements. It was agreed among the parties, at the hearing, that the City and the Company should work together toward a satisfactory resolution of the problems facing the Company and the City, which was so ordered in Order No. 4659.

10. It was decided by the Company and the City that resolution of the problems being experienced by both parties could be accomplished by the sale of the Company to the City. Mr. Jeremy Thane, managing partner of Valley Water Company, offered to sell the Company to the City at a cost equal to the remaining asset life of the various assets times reproduction cost.

11. In the spring of 1981, Mr. Thane commissioned Sorenson and Company, Engineering Consultant, Missoula, Montana to conduct a study of the Valley Water Company system. In part, the study was to determine the following:

1. Estimate the present worth of the system.
2. Determine the existing capacity of the system and make recommendations on bringing the system up to required standards; main capacity, storage, well capacity, automatic controls, etc.
3. Determine a capital improvement program.

In November, 1981, Sorenson and Company presented Mr. Thane with a document entitled "Valley Water Company, Hamilton, Montana, Study and Engineering Report" (study or report).

12. The report indicated that the present value of the Valley Water Company, based on the remaining asset life of the various assets times 1981 reproduction costs, was \$393,334. The report also provided Mr. Thane with information relative to currently existing operating deficiencies on the system and proposed 5 year and 20 year capital improvement programs to correct system deficiencies (proposed capital improvement programs will be discussed later in this Order).

13. After analyzing the information contained in the report, Mr. Thane, representing Valley Water Company as the managing partner, made an offer to sell the Company to the City for a price of \$393,334. The report submitted to Mr. Thane states that the majority of the Company's system was installed between the late 1890's and the late 1930's. This would indicate that the sales price submitted to the City is substantially above the original cost depreciated value of the system because a major portion of the assets were purchased at prices considerably below the 1981 reproduction cost, and also assets in excess of 40 years old should be fully depreciated. By selling the Company at a valuation above the original cost depreciated, the owners of the Company reap substantial monetary benefits. Many regulatory agencies, such as this Commission, have adopted the original cost principle for plant valuation to protect ratepayers from the possibility that sales of a public utility will result in the subscriber paying for any given asset more than once during its useful life. The original cost principle also discourages the purchase of public utilities at prices above the cost to the person first devoting utility property to public service because transfer of utility assets at a level above original cost depreciated is not recognized in rates, unless it is proven that the public interest is better served by allowing such a transfer.

15. The City Council, during its deliberations concerning the purchase of the Company, had available the proposed selling price and a copy of the report submitted by the consulting engineers to Mr. Thane. The City Council was aware of the basis utilized to calculate the proposed selling price and that this price represented a valuation in excess of the original cost depreciated. The Council was also aware of the present operating deficiencies existing on the system and that there existed a need for extensive capital improvements to correct operating deficiencies and bring the system to required standards.

Given these facts, the Council decided to place the issue of purchasing the Company on the election ballot in April, 1982, and have the citizens of the City of Hamilton decide whether or not to purchase the Company.

16. The citizens, through the election process, indicated by majority vote their desire to have the City purchase the Company for the \$393,334 selling price. It must be construed from the results of the election that it was the opinion of a majority of the citizens that the public interest would be better served if the City acquired ownership of the Company.

17. This Commission has general supervisory responsibility over public utilities and an obligation to insure that the public is adequately represented and protected in the sales transaction.

Under normal circumstances, this Commission for ratemaking purposes, would not accept the transfer of utility assets at a level above original cost depreciated, because of the rate impact on subscribers and the ratemaking policy dictates of original cost principles, that obligate the subscriber to pay only for the original cost of an asset.

In this instance, the City Council and the electorate in the affected area have agreed to purchase the Company at a level above original cost depreciated. While this Commission does not condone the transfer of utility property at a level above original cost depreciated, it accepts such a transfer in this instance, because the affected parties (subscribers to the service) through the election process have made a conscious decision to purchase the system at the inflated level.

Current Operation and Maintenance Expense and Debt Service

18. Because the City has just recently obtained the operating responsibility of the water utility, it is not able to provide the Commission with actual historical expense data relating the utility's operation. The City has projected the annual operation and maintenance for the utility based upon its anticipated expenditures for the next year.

19. The City has projected annual operation and maintenance expenses of \$100,000 for the water utility; these expenses include salaries, supplies, utility services, maintenance expense and professional services. The testimony in this Docket supported the City's projection of anticipated operation and maintenance expense and the projection is accepted by the Commission.

20. The City, at the hearing, outlined a need for funds to acquire capital items necessary to operate the water utility. The City has requested that the Commission approve \$22,800 annually to provide funding of a recurring annual capital improvement program. Funds in this account will be used to purchase minor capital items for the utility. The Commission finds that adequate funding of this type of an account is both prudent management and regulation in that it allows for proper system maintenance.

21. The purchase price paid by the City for the acquisition of Valley Water Company was \$393,334. The City proposes to issue \$393,334 in revenue bonds to be repaid over a period of 20 years, bearing an interest rate not to exceed 13%, with the requirement that the City establish a reserve fund in an amount equal to the average principal and interest payment on the bond and also provide a debt service coverage of 125%.

The above described revenue bond issue will require annual debt service in the amount of \$67,200. The Commission finds the financing mechanism for the acquisition costs to be reasonably prudent and, therefore, accepts the City's proposal.

Capital Improvement Program

22. The City, in its application, has set forth a proposed capital improvement program for the water utility. The City proposes a construction program to be funded from a revenue bond issue having a term of 20 years. The following table sets out the proposed improvements to the water system and the estimated cost of the improvement under consideration in this Docket.

| Capital Improvement Program | | Estimated <u>Cost</u> |
|-----------------------------|--|--------------------------|
| 1. | Installation of new 12 inch main under U.S. 93 | \$335,000 |
| 2. | Purchase of 12 inch main for Weber Estates | 44,000 |
| 3. | Install remaining portion of 12 inch supply main along Golf Course Road | - |
| | <u>150,000</u> | |
| TOTAL | | \$529,000 |

23. Item 1 of the proposed capital improvement program is the construction of a new 12-inch main on First Street, from River Street to Hope Avenue. The 12 inch main will replace deteriorated 4 inch and 6 inch mains and permit the Montana Department of Highways to commence reconstruction of Highway 93 in that area. It is a precondition of the Department that these mains be replaced before it commences reconstruction of Highway 93.

24. Item 2 of the proposed capital improvement program is the purchase of the materials for construction of a 12 inch main in the Weber Estates area. With the acquisition of the Company, the City assumed the commitment of Valley Water Company for the purchase of materials for the construction of a 12 inch main in the Weber Estates area, which will replace a portion of an abandoned 12 inch supply line. After purchase of the materials, the developers of Weber Estates will assume the costs and responsibility for installation of the main.

The construction of the new 12 inch main will complete a portion of the necessary system looping to insure the system has the ability to use stored water if there is a main break on the north end, and will also result in improved pressure on the system.

25. Item 3 of the proposed capital improvement program is the installation of the remaining portion of the 12-inch supply main along Golf Course Road. The construction of this supply main along Golf Course Road will complete the system looping and insure the availability of stored water if there is a break in the main on the north end.

26. The Commission finds the capital improvement program as proposed by the City is reasonably prudent and, therefore, accepts the improvements as outlined. The Commission also accepts the City's estimated cost of \$529,000 as being a reasonable estimate of the construction costs.

Debt Service On Proposed Capital Improvements

27. The City proposes to finance the majority of the capital improvements outlined in this Order by the issuance of revenue bonds, but it does have requests pending with various State and Federal programs requesting grant monies to assist with the construction. If grant monies are received, they will be used to decrease the amount of the necessary debt issue for construction of these improvements.

28. The City, in its application, has proposed the issuance of \$529,000 in revenue bonds to be repaid over a period of 20 years, with an interest rate not to exceed 13%, with the

requirement that the City establish a reserve fund in an amount equal to the average principal and interest payment on the bond and also provide a debt service coverage of 125%.

The above described revenue bond issue will require an annual debt service in the amount of \$90,400. The Commission finds the financing mechanism reasonably prudent and accepts the City's proposal with the limitation that the bond issue should be reduced if grant monies are received and the debt service requirement should be reduced if the interest rate is below the 13% recognized herein.

Revenue Requirement

29. The Commission, based upon Findings of Fact Nos. 19, 20, and 21, finds that the City has a current revenue requirement of \$190,000 annually. Determined as follows:

| | |
|-----------------------------|---------------|
| Operation and Maintenance | \$100,000 |
| Recurring Annual Capital | |
| Improvements | 22,800 |
| Debt Service Acquisition | <u>67,200</u> |
| Current Revenue Requirement | \$190,000 |

30. The Commission further finds, based upon the preceding Finding of Fact and Finding of Fact No. 28, that the City will have a maximum future revenue requirement, after issuance of revenue bonds for capital improvements, of \$280,400 annually. Determined as follows:

| | |
|---------------------------------------|---------------|
| Operation and Maintenance | \$100,000 |
| Recurring Annual Capital Improvements | 22,800 |
| Debt Service Acquisition | 67,200 |
| Debt Service Capital Improvements | <u>90,400</u> |
| Future Revenue Requirement | \$280,400 |

Rate Structure

31. The City, in its application, has requested that it be allowed to perpetuate the rate structure that had been previously approved for the Valley Water Company. The City has made this request because there is not sufficient data available at this time for it to present an allocated cost of service study. It is the City's intention to file a rate structure case with this Commission no later than September, 1983, after it has had one year's operating experience, that will implement equitable rates for the various user classifications based upon the cost of providing service.

The Commission, for purposes of this Order, accepts the City's request to perpetuate the previously approved rate structure for Valley Water Company, with the understanding that a rate structure case will be filed no later than September, 1983

CONCLUSIONS OF LAW

1. The Montana Public Service Commission properly exercises jurisdiction over the parties and the subject matter in this proceeding. Title 69, Chapters 3 and 7, MCA.
2. The Commission afforded all interested parties notice of and an opportunity to participate in this proceeding. Section 69-3-303, MCA.
3. The rates approved herein are reasonable and just. Title 69, Chapter 3, MCA.

ORDER

NOW THEREFORE IT IS ORDERED by the Commission that the City of Hamilton shall file tariffs consistent with the Findings of Fact for Docket No. 82.5.33 contained herein.

IT IS FURTHER ORDERED that the City of Hamilton is authorized to implement rates in a two-step procedure. Step one of the rates shall recognize the costs as indicated in Finding of Fact No. 29, which are currently in effect based on Interim Order No. 4910 and are hereby made permanent. Step two of the rates shall recognize costs associated with the issuance of water revenue bonds as indicated in Finding of Fact No. 30, and shall become effective upon Commission approval subsequent to the issuance of the bonds.

IT IS FURTHER ORDERED that the rates approved herein for the capital improvement program shall not become effective until the tariffs and necessary calculations, relating to grant monies received and applicable interest rate, for the bond issue have been submitted for approval by the Commission.

IT IS FURTHER ORDERED that the City shall file a rate structure case with this Commission no later than September 30, 1983.

IT IS FURTHER ORDERED that a full, true and correct copy of this Order be sent forthwith by first-class United States mail to the Applicant and all other appearances herein.

DONE IN OPEN SESSION this 7th day of February, 1983 by a vote of 5-0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

THOMAS J. SCHNEIDER, Chairman

JOHN B. DRISCOLL, Commissioner

HOWARD L. ELLIS, Commissioner

CLYDE JARVIS, Commissioner

DANNY OBERG, Commissioner

ATTEST:

Madeline L. Cottrill
Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See 38.2.48.06, ARM.